Mizuho Custody Newsletter

June 2023 | Japan

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I. Market News

1. Shareholders are proposing for wide range of reforms

Managements at listed companies have been getting nervous for the AGM. 82 companies holding their shareholders meetings in June received proposals from the shareholders, which was the record high, reports Nikkei Shimbun, Japan's leading financial daily. Shareholders propose companies a wide range of reforms, including improvements in capital efficiency and more engagement in de-carbonization. Institutional investors are looking more at shareholders proposals, and tend to vote for shareholders proposals more often than ever, depending on the content. This often causes intensive debate over measures to increase corporate value between the management and shareholders.

In June, more than 2,000 listed companies with their fiscal year end in March hold shareholders meeting. According to a major trust bank acting as a registrar, 314 proposals were sent to 82 companies as of 31 May. It may increase or decrease as of the end of June, but it will exceed the record high made in FY2022.

The point is "capital efficiency".

A British investment fund proposed special dividend to a construction company. As the return on equity (ROE) was below the cost of capital, and that the improvement on PBR (price to book ratio) was insufficient, the fund pointed out that "further retention of profits by the company should be avoided."

Tokyo Stock Exchange ("TSE") has been trying hard to raise listed companies' awareness towards "capital costs and share prices" more than ever. In March, TSE issued a comment that about half of the companies listed on the Prime market have ROE below 8% and PBR below 1x, which seems to reflect those companies' issues in capital profitability and growth.

Some companies receive suggestions from shareholders to improve capital efficiency one after another. A U.S. investment manager submitted requests to some companies to buy back their shares.

There are also disputes over management control. An investment fund who is the largest shareholder of a construction company and proposing for a takeover is proposing for the company to appoint nine directors including their internal directors.

Institutional investors have been taking different approaches toward shareholder proposals from how they used to be. Since the adoption of the Stewardship Code (a code of conduct for institutional investors), shareholders have been getting less hesitant to vote in favor of shareholder proposals if they recognize the proposals will help improve the corporate value.

To retrieve the details of the Stewardship Code, please refer to the following URL:
https://www.fsa.go.jp/en/refer/councils/stewardship/20200324/01.pdf

Compiled from Financial Services Agency, Nikkei Shimbun and Mizuho research.

2. Japanese companies are increasing distribution to shareholders

Japanese companies are going to pay more dividends to shareholders. Total corporate dividends for the year ending March 2024 will be expected to reach JPY 15.2 trillion, setting the highest record for three consecutive years, reports Nikkei Shimbun, Japan’s leading financial daily. Announcements of share buybacks plans are also coming close to the record high. The point is that how to strike a balance between shareholder returns and investment in human resources and equipment to fix the "PBR (price-to-book ratio) below 1x" situation that undermines shareholder value.

Nikkei Shimbun has compiled a list of dividend plans (or market forecast) for listed companies that compare their dividends paid in the previous fiscal year. It is forecasted in the list that companies for the fiscal year ending March 2024 would pay dividend of JPY 15.22 trillion in total, about JPY 100 billion higher than the previous record of the fiscal year ending March 2023. 30% of the companies announced plans to pay more dividends in spite that the global economy outlook still remains uncertain.

There have also been active moves to buy back shares as part of shareholder allocations enhancement. This year, Japanese companies set more than JPY 5.16 trillion in stock repurchase lines in total by the end of May. It has been going very similar to 2022, which made the record high of the annual figure of JPY 9.4 trillion.

The Tokyo Stock Exchange (“TSE”) has also been taking actions to encourage companies to reward more to shareholders. At the end of this March, TSE has asked listed companies whose PBR is less than 1x to disclose and implement specific measures to raise their share prices. At that point, a little less than 50% of the companies listed on the TSE's Prime Market had their “PBR less than 1x”, which means they were not enhancing the value of the capital from shareholders.

Their low PBR is due to excessive cash reserves on hand. At the end of 2022, cash reserves of the listed companies (excluding financial institutions) accumulated to about JPY 100 trillion. Primarily, listed companies act to improve their corporate value by using the money they earned from their businesses to invest in human resources, research and development, and capital expenditures. The extra money will be distributed to shareholders through share buybacks and dividends.

It is hard to say that Japanese companies have been doing well in all of the above mentioned original activities. According to the OECD, wages in the U.S. companies (in U.S. dollars) have increased about 1.5 times over the past 30 years. However, wage curve in Japan has been almost flat for the same period. Shrink of consumption in households due to dismal outlook for a raise lead the economy to a contracted equilibrium.

Comparing the "total return ratio," which measures how much of a company's net income it has allocated to dividends and share buybacks, the rate for the 500 largest U.S. companies was nearly 100%, but Japan's rate stood at 50%. It was one of the factors that Japanese shares didn’t attract foreign investors.

Japanese companies aren't sitting on their hands either. In addition to strengthening shareholder distribution, they began to shift management strategy of hoarding much cash at hand to that of making good use of cash at hand.

According to Corporate Business Statistics by the Ministry of Finance, capital investment in all industries excluding finance and insurance rose by 11% from a year earlier to JPY 16.54 trillion in the first quarter of 2023, the highest level in the recent 15 years. According to a tally by Japanese Trade Union Confederation - Rengo, the rate of wage increase in the spring labor negotiations in 2023 was 3.66%, the highest level in 30 years.

"Now at a time deflation is ending, the management of Japanese companies would be serious to make investment decisions quicker, which would invigorate economic activities" predicts a money manager at a leading investment firm in the U.S. Some foreign investors have been reallocating money into Japanese stocks in anticipation of structural changes in the Japanese economy, which has been pushing up stock prices.

For details of the notice by the TSE asking the listed companies whose PBR is less than 1x to disclose and implement specific measures to raise share prices,

please refer to the following URL:
https://www.jpx.co.jp/english/news/1020/e20230414-01.html

Compiled from Nikkei Shimbun, Tokyo Stock Exchange and Mizuho research.

3. More and more listed companies are hiring female directors

More and more listed companies are hiring female directors in Japan, reports Nikkei Shimbun, Japan's leading financial daily. 28 major companies with the fiscal year ending in March do not have any female directors, and 18 of them submitted a proposal to appoint female directors at their shareholders in June. The government has set a goal of having women account for 30% of board members at listed companies by 2030, which implies that the trend toward greater diversification is likely to continue.

According to a survey by a leading trust bank, among 388 companies who are composite of the Nikkei 500 stock average for the fiscal year ended in March, only 7.2% of them have no women on their boards, and the rate will drop to 3% if all the proposals for this purpose are approved.

Board of directors are responsible for decision-making and supervision of the company. It is now believed "the more diversified a company becomes, the better decisions the company can make more". Institutional investors have urged companies to proceed reform. They have altered their voting standards for companies that have no female directors to demand to review of their board of directors' lists.

One of the leading asset management firms in Japan revised its voting standards for ones listed on the Prime market to vote against a proposal to appoint the top management of companies that have no female directors, effective from AGMs held in 2023. In February, an American voting advisory firm, having influence over foreign investors, has introduced a new advisory standard to recommend nay votes to companies' proposals of selection of the top management, if the company has no female directors.

The government will demand companies being listed on the Prime Market of the Tokyo Stock Exchange to have 1 or more female director (including corporate auditors and executive officers) by 2025, and to make female directors account for 30% of the board members by 2030. Companies with insufficiently diversified board of directors will have to take actions to deal with it.

Currently, many listed companies tend to appoint female directors from external entities. According to a research by a major trust bank, at 80% of the companies researched, all female directors appointed were external directors. Women who had been promoted from within exist at only 12.4% of them.

While companies are rushing to hunt women for their board members, the thing is whether they can secure enough people who are capable for helping their boards work properly, not just in terms of the gender.

For details of the current situation of female directors at the listed companies, please refer to the website of the Gender Equality Bureau Cabinet Office from the following URL (in Japanese only):

https://www.gender.go.jp/policy/mieruka/company/yakuin.html

Compiled from Gender Equality Bureau Cabinet Office, Nikkei Shimbun and Mizuho research.

4. Domestic insurance companies are increasing their appetite on private assets

Domestic insurance companies are increasing their appetite on private assets (unlisted assets). According to a recent survey by a U.S. investment firm, 71% of the domestic insurers responded they would plan to invest more in unlisted assets in the next 12 months, reports Nikkei Shimbun, Japan's leading financial daily. Based on its strong financial backgrounds, it will invest more in assets that have become more attractive due to the recent drops in prices.

A U.S. investment firm surveyed 343 life and nonlife insurance companies worldwide. Total size of assets under management exceed $13 trillion (JPY 1,800 trillion). About 40 domestic insurance companies responded from Japan.

The percentage of respondents from Japan who would "increase" unlisted investment far exceeded the global total (51%). The percentage of respondents who said they would "maintain the current level" was 29% (compared with 43% globally), while none said they would "reduce" (compared with 6% globally).

Domestic life insurance companies mainly invest in Japanese government bonds. As many of their insurance products have long maturities, which makes duration of their liabilities also long, they tend to prefer investments with longer maturities on their asset side to minimize interest rate risk. "The recent rise in Japan's ultra-long-term interest rates has made it easier to make duration of their portfolio longer, giving more freedom to channel funds into risky assets" said a person who directed the survey.

By asset category, private-equity ranked the first with a ratio of 57%, the ratio after subtracting the number of respondents with intention to reduce their investment in the future from those with intention to increase. It went above U.S. investment-grade corporate bonds (49%) and was much higher than the global average (23%). Private debt, in which funds directly finance to companies, also came in fourth at 46%.

On the other hand, in assets where the ratio of "to be decreased" exceeded the "to be increased", "cash" and "emerging market government bonds" both came out on top with a net 11%.

At present, unlisted companies are having difficult times to find financial resources. Recent collapse of regional banks in the U.S. has cast a shadow over the cash-flow of small and medium-sized companies and venture companies. On the other hand, falling prices of their assets may look attractive to investors.

"Japanese insurance companies are lagging behind other countries in the area of unlisted investment, and they are now closely looking at them. They prefer relatively low-risk items with covenants in the area of private debt," says the person who directed the survey.

Insurers are less exposed to investment-related risks than banks are. Since bank deposits can be withdrawn at any time, if deposits are withdrawn, the bank may have to sell assets even if the assets have unrealized losses as well if necessary. Insurance products, on the other hand, tend to be on long-term contracts, which means they are less likely to be rushed to sell their assets to get cash to pay for the clients. It is one of their advantages to invest from a long-term perspective. It is also important that most of the assets under their management are highly liquid assets such as government bonds.

Domestic players also have appetite for products with higher-risks than ones of other countries do. 51% (on net basis) of respondents said they would take more credit risk in the future, surpassing the U.S. (11%). As U.S. insurance companies have been shying away from investing in assets with more risks due to the recent financial instability, the presence of the Japanese insurance companies, which have had tough times in finding attractive instruments under the low interest rates, is growing.

Japan Securities Depository Center, Inc. ("JASDEC") has revealed the draft guidelines to handle unlisted stocks, etc. under the book-entry system, planning to implement in April next year. For the details of the draft guidelines available in Japanese only, please refer to the following URL:

http://www.jasdec.com/download/news/youkou20230428.pdf

Compiled from JASDEC, Nikkei Shimbun and Mizuho research.

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Jun-29	W TOKYO	JP3506020001	G
Jun-30	NOVARESE	JP3762110009	ST
Jun-30	GDEP ADVANCE	JP3386880003	ST
Jun-30	KURADASHI	JP3268820002	G
Jul-3	Integrated Design & Engineering Holdings	JP3104770007	PR
Jul-4	AeroEdge	JP3161020007	G
Jul-5	Bleach	JP3830770008	G
Jul-7	GRID	JP3274160005	G
Jul-21	Nareru Group	JP3652120001	G
Jul-21	HOLOS Holdings	JP3853240004	ST
Jul-24	TRYT	JP3635510005	G
Jul-25	Fuller	JP3826290003	G
Jul-26	EcoNavista	JP3161360007	G
Jul-26	TECNISCO	JP3545300000	ST
Jul-28	GENDA	JP3386890002	G
Jul-28	Qualtec	JP3266010002	G
Jul-31	Laboro. AI	JP3968350003	G

**Information compiled based on postings from the Prime (PR), Standard (ST), Growth (G), Tokyo Pro Market (P), NSE (N)、 FSE (F) & SSE (S).*

***Board lot size is unified to 100*

III. Foreign Ownership Limit Ratio

Click for up-to-date FOL information:
http://www.mizuhobank.com/service/custody/actions.html

Please visit our Custody homepage on the Web at:
http://www.mizuhobank.com/service/custody/index.html